HYBRID ANNUITY MODEL (HAM) PROJECT

Accounting Aspects: IND AS 115

21.02.2021

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COVERAGE

1. Introduction: Ind AS 115 and Annexure D: Service Concession Arrangements
2. Five (5) step model for applying Ind AS 115
3. Recognition of Financial Asset, Contract Asset and Contract Liability

Ind AS 115 – Scope and Applicability

IND AS 115

- Ind AS 115 relates to **revenue from Contracts with customers**
- Ind AS 115 is similar to IFRS 15 issued by IFRS Foundation and the International Accounting Standards Board.

Scope

- Establish the principles that an entity shall apply to report useful information to users of financial statements ***about the nature, amount, timing and uncertainty of revenue and cash flow arising*** from a contract with a customer .

Applicability

- Barring few exceptions, the ***Ind AS 115 applies to all the contracts*** with the customers, to provide goods and services for a consideration
- Annexure D of the Ind AS 115 relates to **Service Concession Agreements.**

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Annexure D – Service Concession Arrangements

- **Annexure D** gives guidance on the *accounting by operators for public-to-private service concession arrangements*.
- It sets out general principles on recognizing and measuring the obligations and related rights in *service concession arrangements.*
- In terms of Para 2 of Appendix D an arrangement within the scope of this appendix typically involves a private sector entity (an operator) ***constructing*** the infrastructure used to provide the public service or upgrading it and ***operating and maintaining*** that infrastructure for specified period of time.
- Appendix D shall apply to public-to-private service concession arrangements if [para 5]:
  - the **grantor controls** or regulates **what services** the operator must provide with the infrastructure**, to whom** it must provide them, and **at what price**; and
  - the **grantor controls**—through ownership, beneficial entitlement or **otherwise—any significant residual interest in the infrastructure** at the end of the term of the arrangement.

Annexure D – Service Concession Arrangements

- The operator shall ***recognize*** and ***measure*** revenue in accordance with Ind AS 115 for the services it performs (para 13).
- Operator shall also recognize a ***Financial Asset*** to the extent it has an unconditional right to receive cash or other financial asset for or at the direction of grantor for the construction services (Para 16).

ALA Comments

- Clause A of the Para 5 creates a slight confusion – this aspect is clarified by Application Guidance on Appendix D. It is stated that the control or regulation referred to in Condition (a) could be by contract, and includes circumstances in which the grantor himself buys all the output.
- Further, Information Note 2 that accompanies Appendix D provides guidance on applicability of different Ind AS to typical types of public-to-private arrangements. As per the said Information note 2, Appendix D: Service Concession Agreement shall apply in case of projects under BOT Model. HAM projects, being DBOT, are similar to BOT model

Annexure D – Service Concession Arrangements

ALA Comments

- Since, in terms of HAM projects, Concessionaire is required to construct/ upgrade the national Highways and thereafter operate and maintain the same, hence, it seems that Concession Agreement would be covered within the Appendix D: Service Concession Arrangements.
- Accordingly, revenue of Concessionaire shall be recognized and measured in accordance with Ind AS 115.
- Concessionaire is also required to recognize Financial asset to the extent it has an unconditional right to receive cash or other financial asset (*we have discussed this aspect at the end of this presentation*).

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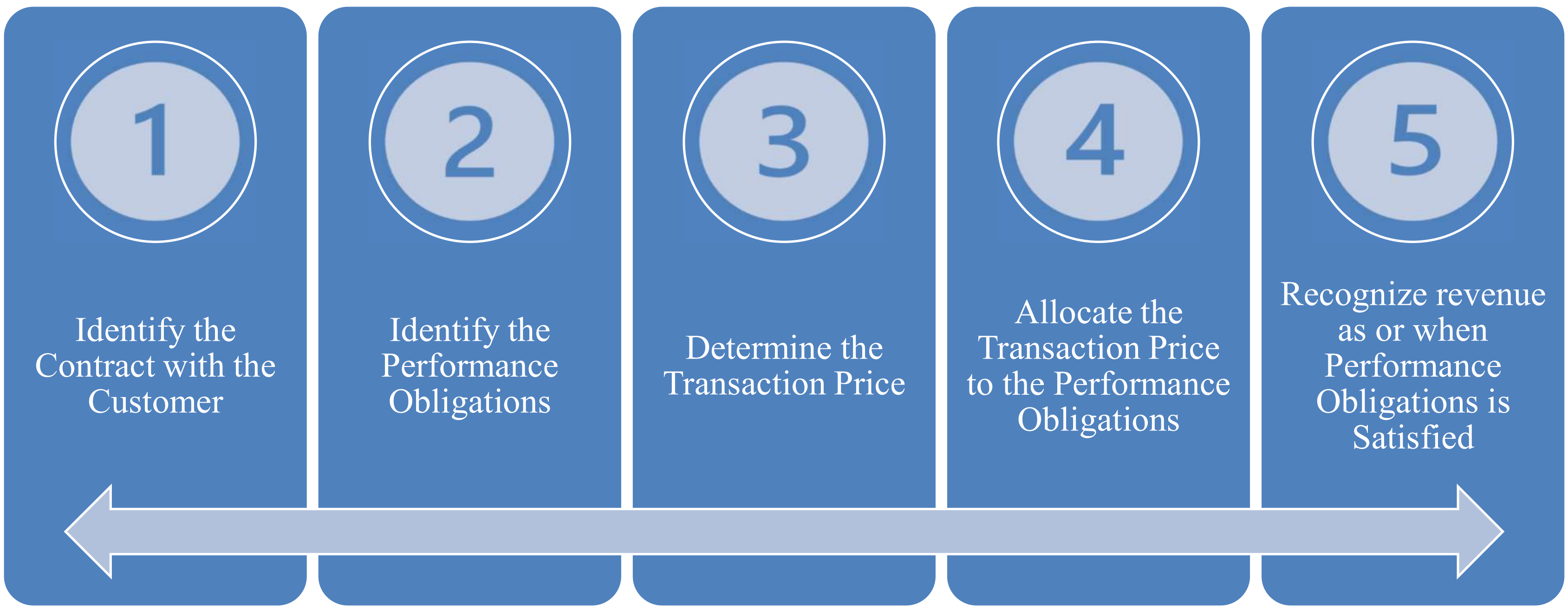
Five (5) Step Model for applying IndAS 115

IND AS 115

- Five (5) step model to be applied for determining the ***amount of revenue to be recognized*** and ***when to recognize*** the same.



Case Study Example

- NHAI has awarded a concession agreement for Design, Build, Operate and Transfer of a stretch of National Highway under HAM (hereinafter referred to as “Project”). In terms of the concession agreement the Concessionaire, being “Contractor Pvt. Ltd.” (hereinafter referred to as “CPL”), is required to perform the following activities:
  - Construction of Highway; and
  - After completion of Construction/ Operation and maintenance (hereinafter referred to as “O&M”) of Highway for 15 years. Operation and maintenance activities would include regular maintenance as also major maintenance.

- Estimated cost of construction by CPL is Rs. 500 Cr (1st year: Rs. 300Cr.; 2nd year: Rs. 200 Cr.)
- Estimated O&M cost to be incurred each year is Rs. 20 Cr. In addition to this, during 8th year and the 15th year of operation period, Rs. 25 Cr. is estimated to be incurred in respect of major maintenance for both years.
- Bid Project Cost – quoted – Rs. 800 Cr.
- O&M Cost – quoted – Rs. 20 Cr. Thus, total of Rs. 300 Cr. (Rs. 20 crore x 15) is quoted, which shall be received over a period of 15 years.

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Case Study Example

- Estimated cost and agreed revenue is summarized below:

Activities/ cost and revenue	Construction (in Cr.)	O&M (in Cr.)	Total (in Cr.)
Cost	500	350	850
Revenue quoted	800	300	1100

- The consideration agreed between NHAI and CPL is to be paid by NHAI in the following manner:
  - NHAI shall pay 40% of the cost of construction of the Bid Project Cost on achievement of milestones linked with the physical completion of the project in 10 equal instalments of 4% of bid project cost.
  - Upon Commercial Operation Date ("COD"), CPL shall be entitled to demand and collect remaining 60% of bid project cost as Annuity payments – as 30 bi-annual Annuities.
  - NHAI would also pay interest on the outstanding annuities payments.
  - CPL would also receive O&M payments (as per the bid of the CPL) during the 15 years of operation period.

Step 1:Identify the contract with the customer

Step 1: Identify the contract with the customer

An entity while applying the provisions of Ind AS 115 shall first have to identify the contract as per the parameters laid in para 9 of the Ind AS

Para 9 of Ind-AS 115

An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

*(a) the **parties to the contract have approved the contract** (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;*

*(b) the **entity can identify each party's rights** regarding the goods or services to be*

transferred;

*(c) the entity **can identify the payment terms for the goods or services to be transferred**;*

*(d) the **contract has commercial substance** (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and*

*(e) **it is probable that the entity will collect the consideration** to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 52).*

Step 1: Identify the contract with the customer

ALA Comments

- In respect of HAM projects all the five criteria as laid down in Step I are met and the same are explained in the following points:
  a) In the HAM, the concession agreement that is entered is duly executed, signed and approved by both the parties to the contract.
  b) The right of both the parties are clearly codified in the contract.
  c) The payment terms are also provided for in the Concession agreement wherein the total price and the timing for its payments is mentioned. (Clause 23)
  d) Concession agreement in HAM has commercial substance as the concessionaire's risk and future cash flows would change as a result of the HAM project.
  e) In HAM, the contracting party is NHAI or State Authority i.e. Authority of Government of India thus, it is fairly probable that the concessionaire will collect the consideration
- **Thus, first step of 'identification of contract' is complied with in respect of HAM projects.**

Step 2: Identify the performance obligations

Step 2: Identify the performance obligations

- The next step requires an entity to identify the performance obligations in the contract. The relevant para of Ind- AS is reproduced below:

<u>Para 22 of Ind-AS 115</u>

At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

(a) a good or service (or a bundle of goods or services) that is distinct; or

(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).

- In terms of step II the entity is required to assess the goods and services promised in a contract. Thereafter, the entity has to determine whether such promised goods or services to be transferred to customer are distinct in themselves or form a series which has a same pattern of transfer.

Step 2: Identify the performance obligations

- **Test for determining distinct goods or services**: Ind AS 115 also provides criteria for determining whether the good or service that is promised to customer would be distinct or not. The relevant para of Ind AS 115 is reproduced below for ready reference:

<u>Para 27 of Ind-AS 115</u>

A good or service that is promised to a customer is distinct if both of the following criteria are met:

*(a) the **customer can benefit from the good or service either on its own** or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and*

*(b) the **entity's promise to transfer the good or service to the customer is separately identifiable from other promises** in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).*

- The two conditions specified in Para 27 are to be cumulatively satisfied. In other words, a good or service that is promised to a customer shall be considered to be distinct only if both the above conditions (a) and (b) are satisfied.

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Step 2: Identify the performance obligations

- **Reference is also placed on para 29 of IndAS 115:** Provides for factors that indicates that two or more promises to transfer goods and services are not ***separately identifiable.*** Relevant portion of para 29 is reproduced below:

Para 29 of Ind-AS 115

Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following: (a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.

Step 2: Identify the performance obligations

Analysis of case study

- In the Case study CPL is providing two major services viz. Construction Services and Operation & Maintenance services which are made up of various minor services such as engineering, site clearance, foundation, procurement, construction of the structure, maintenance and repairs.
- **Criteria mentioned in para 27(a):**
  - **The Construction services and the O&M service promised by Concessionaire to NHAI are capable of being treated as distinct in accordance with paragraph 27(a).**
  - **This is because NHAI can benefit from the constructed services, as well as O&M services on their own.**
  - **Further, in many cases NHAI procure both these services, viz Construction service and O&M services separately from different entities.**
- **Criteria mentioned in para 27(b):**
  - **Both the services i.e. construction as well as O&M are separately identifiable under the contract.**
  - **This is further evident on the basis of the fact that the time for performing both these services is completely different.**

Thus there are two performance obligations i.e. construction services and O&M service

Step 3: Determining Transaction Price

Step 3: Determining Transaction Price

- The next step is to determine the transaction price which the entity expects to receive in exchange of transferring the promised goods and services. The relevant provisions are reproduced below:

Para 47 of Ind-AS 115

*An entity shall **consider the terms of the contract** and its **customary business practices** to determine the transaction price. **The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer**, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.*

Para 49 of Ind-AS 115

For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.

Step 3: Determining Transaction Price

ALA Comments

- HAM projects generally have two performance obligations i.e. construction service, and operation and maintenance service. Further in terms of the model concession agreement, Article 23, separate prices for both the obligations are quoted and agreed by the concessionaire and Authority.
- Thus, there may be two scenarios:

1	Price quoted for each performance obligation is same as consideration expected in exchange for promised services	Price quoted is treated as "Transaction Price" for each performance obligation
2	Price quoted for each performance obligation is different from consideration expected in exchange for promised services.	"Transaction Price" for each performance obligation needs to be determined.

- In scenario 2, the transaction price for whole of the contract is determined and then the same is allocated between different performance obligations on the basis of principles laid down in step 4

Step 3: Determining Transaction Price

ALA Comments

- In our view, in order to preserve the substance of the contract, TP for whole contract needs to be determined and then the said TP shall be allocated to each of the performance obligation in terms of next step.
- As per Para 48, while determining the transaction price, an entity shall consider the effects of all of the following:
    a. Variable consideration
    b. constraining estimates of variable consideration
    c. the existence of a significant financing component in the contract
    d. non-cash considerations
    e. consideration payable to a customer
- In HAM Projects BPC and O&M payments are adjusted for the inflation index. This adjustment on account of inflation is variable consideration.

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Step 3: Determining Transaction Price

ALA Comments

- While estimating variable consideration, which is to be based upon the inflation factors prevailing over a period of 17 years approximately, there shall be substantial degree of estimation. However, the accountants have no option but to make best estimates possible.

Step 3: Determining Transaction Price

ALA Comments

- In terms of para 60 While determining TP, an entity shall adjust the promised amount of consideration for the ***effects of the time value of money*** if the timing of payments agreed to by the parties to the contract provides the customer or the entity with a ***significant benefit of financing***.

Objective

- is for an entity to recognize revenue
- at an amount that reflects
- the price that a customer would have paid
- for the promised goods or services
- if the customer had paid cash for those goods or services
- when (or as) they transfer to the customer (**i.e. the cash selling price**)

Step 3: Determining Transaction Price

- Para 60 of Ind AS 115 provides that the effects of significant financing component must be adjusted while determining the transaction price. The relevant provisions relating to financing are reproduced below:

Para 60, page 12 of Ind-AS Text

The existence of a significant financing component in the contract

60 In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

61 ***The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognize revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (i.e. the cash selling price)****.*

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Step 3: Determining Transaction Price

ALA Comments

- Concessionaire is financing significant portion of the Bid project Cost i.e. appx. 60% of the project cost and in lieu of same, NHAI is paying interest to be calculated at (1-year MCLR of top 5 scheduled commercial banks + 1.25%) to Concessionaire.
- For adjusting TP for significant financing component, entity shall use the **discount rate** that would be **reflected in a separate financing transaction** between the entity and its customer at contract inception. That rate would **reflect the credit characteristics** of the party receiving financing in the contract.
- In terms of para 60 to 65, the concessionaire needs to analyze whether the price quoted in the contract is the cash selling price or it includes any significant component on account of significant financing. If there is a significant financing component, the promised amount of consideration shall be adjusted for the financing component on the basis of the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.
- However, it would be for the **management to consider** and **decide** whether the price quoted in the Agreement would have been indeed the cash selling price if there was no component of financing.

Step 3: Determining Transaction Price

Analysis of case study

- **In the case study, as mentioned in the facts, there is no significant financing component in the contract price. Thus, the transaction price for complete project would be Rs. 800 Cr + Rs. 300 Cr (to be paid over concession period) i.e. Rs. 1,100 Cr..**
- **Further, in the case study there is no mention of inflation, thus the effect of inflation has not been considered.**

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Step 4: Allocate the TP to Performance Obligations

Step 4: Allocate the TP to Performance Obligations

- The provisions relating to allocation of transaction price are reproduced below:

Para 73-75 of Ind AS 115

73 The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

74 To meet the allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis in accordance with paragraphs 76–80, except as specified in paragraphs 81–83 (for allocating discounts) and paragraphs 84–86 (for allocating consideration that includes variable amounts).

75 Paragraphs 76–86 do not apply if a contract has only one performance obligation. However, paragraphs 84–86 may apply if an entity promises to transfer a series of distinct goods or services identified as a single performance obligation in accordance with paragraph 22(b) and the promised consideration includes variable amounts.

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Step 4: Allocate the TP to Performance Obligations

- Para 79 of Ind AS provides suitable methods for estimating the **stand-alone selling price** of a good or service. The list is not limited but includes following:

Adjusted market assessment approach

- *an entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. That approach might also include referring* ***to prices from the entity's competitors for similar goods or services*** *and adjusting those prices as necessary to reflect the entity's costs and margins*

Expected cost plus a margin approach

- *an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service*

Residual approach

- *an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract*

Step 4: Allocate the TP to Performance Obligations

ALA Comments

- In respect of HAM Projects, selling price of each of the performance obligations i.e. construction and O&M is difficult to estimate.
- This is so because, every road is different from the other. Unlike standard machine made commodities, where it is relatively easier to determine selling price, construction contracts usually have their own peculiarities.
- Thus, the stand-alone selling prices should be determined on the basis of ***expected cost + margin*** approach and the said stand-alone selling price be used for apportioning the Total Transaction price between the two performance obligations i.e. Construction services and Operation maintenance as identified in earlier step.

Step 4: Allocate the TP to Performance Obligations

Analysis of case study

- **The total estimated cost for whole project is Rs. 850 Cr. (Rs. 500 Cr. + Rs. 350 Cr.); and the total contract price is Rs. 1100 Cr. (Rs. 800 Cr. + Rs. 300 Cr.). Thus, the margin is Rs. 250 Cr. and the profit margin percent on cost is 250/850 = 29.41%. Allocated transaction price is shown below**

Parameter	Construction (in Rs. Cr.)	O&M (in Rs. Cr.)	Total (in Rs. Cr.)
Cost	500	350	850
Margin@29.41%	147	103	250
Allocated Transaction Price	647	453	1100
Revenue quoted	800	300	1100

Step 5: Recognizing revenue

Step 5: Recognize revenue

- In the fifth and the last step, revenue shall be recognized ***as and when the performance obligation is satisfied.*** A performance obligation is said to be satisfied when the promised goods or service is ***transferred***.. The relevant para of Ind AS is reproduced below:

Satisfaction of Performance Obligations

Para 31, of Ind-AS 115

An entity shall recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. ***An asset is transferred when (or as) the customer obtains control of that asset.***

Step 5: Recognize revenue

- A transfer of an asset is said to be made when the customer obtains the control of that asset. '***<u>Controls</u>***' has been defined very widely. The relevant para of Ind AS is reproduced below:

<u>Para 33, of Ind-AS 115</u>

Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

(a) using the asset to produce goods or provide services (including public services);

(b) using the asset to enhance the value of other assets;

(c) using the asset to settle liabilities or reduce expenses;

(d) selling or exchanging the asset;

(e) pledging the asset to secure a loan; and

(f) holding the asset.

Step 5: Recognize revenue

- Where the performance obligation is spread over various financial years, as in the case of HAM projects, Ind AS 115 states that a performance obligation can be satisfied over time or at a point of time. It can be said to have been satisfied over time, if any of the criteria mentioned in para 35 is satisfied.

<u>Para 35, page 7 of Ind-AS Text</u>

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time, if <u>one of the following criteria</u> is met:

(a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);

(b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or

(c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).

Step 5: Recognize revenue

ALA Comments

- In respect of the case study, both the performance obligations i.e. construction and operation and maintenance would be considered to be satisfied over time.
- The criteria mentioned in para 35(a) i.e. "the customer simultaneously receives and consumes the benefits provided by the entity's performance as the asset is created or performed" is satisfied for both the performance obligations.
- Further the criteria given in para 35(b) i.e. the entities performance creates or enhances an asset that the customer controls as the asset is created or enhanced is also satisfied in respect of construction obligation.

Step 5: Recognize revenue

- Where performance obligation is **satisfied over time**, an entity shall recognize revenue over time ***by measuring the progress towards complete satisfaction of that performance obligation*** at the end of each reporting period. Appropriate method includes output method and input method.
- Thus, an entity can measure the progress towards complete satisfaction of performance obligation either as per input method or output method or any other method as may be deemed appropriate by entity. While applying these methods following must be kept into consideration:

OUTPUT METHOD

- Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed and units produced, or units delivered.
- In the case of HAM projects, the concessionaire may use the report provided by the Project Engineer to access the performance of performance obligation.

INPUT METHOD

- Input methods recognize revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labor hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation.
- While applying the input method the entity should keep in mind that the cost incurred during the financial year does not relate to the future expenses.

Step 5: Recognize revenue

ALA Comments

- In respect of HAM projects, the concessionaire can use any method to measure the progress towards complete satisfaction of performance obligation i.e. either output method or input method.

Analysis of case study

- **In respect of the present case study, there is no specific information available to apply the output method (like the report of independent engineer), so input method is applied to measure the progress of performance obligation satisfied over time for CPL.**
- **In the next page the we have summarized the amount of revenue that needs to be recognized by CPL**

Step 5: Recognize revenue

Year		Construction	O&M
Total estimated cost		500	350
Year 1	Cost incurred	300	0
	% completion	60%	0
Year 2	Cost incurred	200	0
	% completion	40%	0
Year 3-17 (except for year 10 and 17 when major maintenance need to be done	Cost incurred	0	20
		0	5.7%
Year 10 and 17 (major maintenance years)		0	20+25
		0	12.86%

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Recognition of Financial Asset, Contract Asset and Contract Liability

Financial Asset

- In terms of Annexure D, an entity is required to recognize a Financial Asset ("***FA***") to the extent it has an ***unconditional contractual right*** to receive cash or another financial asset from or at the direction of the grantor for the construction services. Relevant paras of Appendix D are reproduced below:

Consideration given by the grantor to the operator

15 If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognized in accordance with Ind AS 115. The consideration may be rights to:

(a) a financial asset, or

(b) an intangible asset.

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Financial Asset

*16 The **operator shall recognize a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services; the grantor has little, if any, discretion to avoid payment**, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.*

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Financial Asset

- In accordance with above provisions, an entity shall recognize a financial asset to the extent the entity has **unconditional contractual right to receive cash or another financial asset** from or at the direction of the grantor for the construction services.
- As per Article 23, para 23.4 of MCA, concessionaire receives installment of 4% of bid project cost, adjusted for inflation, during construction period upon physical completion of pre-determined milestones (total of ***40% of BPC*** received during the period of construction).
- As per our view, the financial asset should be recognized as and when the milestone as provided in Article 23 of the Agreement is achieved by the concessionaire and accordingly the payment against that milestone is guaranteed under the Agreement.
- Further, in terms of Article 15.1 of MCA, the Concessionaire receives an unconditional right to receive the balance of appx. ***60% of the BPC*** as and when the construction is complete and COD is issued.
- Thus, the Financial Asset equal to appx. 60% of BPC should be recognized as and when construction is complete and COD is issued to the concessionaire.

Measurement - Financial Asset

Measurement of FA

- In terms of para 24 of Appendix D of the Service Concession Agreement the Financial Asset so created shall be recognized in accordance with Ind AS 109 and would be measured at:
  - a. **Amortised cost; or**
  - b. **Fair value through other comprehensive income; or**
  - c. **Fair value through profit and loss**
- Where the Financial asset is measured at amortised cost or fair value through other comprehensive income, interest should be recognized in the profit and loss account using the effective interest method (as per the requirement of Ind AS 109).

Financial Asset – case study

Analysis of case study

- **In 1st year CPL has completed 60% of construction work. Thus, in first year, CPL has achieved 7 milestones; and earns an unconditional right to receive 28% of the Bid project cost and accordingly, financial asset of 28% of Rs. 800 Cr = Rs. 224 Cr. would be recognized. The same would be reduced by the actual amount received and if Rs. 224 Cr. is received in 1st year, the closing balance of financial asset account would be NIL.**
- **In the 2nd year, CPL completed the physical construction (however, the CoD is yet to be achieved). Thus, CPL further achieved 3 milestones; and earns an unconditional right to receive further 12% of the Bid project cost. Accordingly, financial asset of 12% of Rs. 800 Cr = Rs. 96 Cr. would be recognized. The same would be reduced by the actual amount received and if Rs. 96 Cr. is received in 1st year, the closing balance of financial asset account would be NIL.**

Financial Asset – case study

Analysis of case study

- **As on the COD date, CPL is required to recognize the financial asset equal to that remaining portion (60%) of bid project cost which is payable by NHAI to CPL in equal bi-annual installments.**
- **The fact that the said balance amount would be due and payable to the concessionaire in bi-annual installments over the period of 15 years commencing from COD would not make any difference for the purpose of recognition of financial asset as the unconditional right to receive balance payment would arise immediately after completion of construction.**
- **On the balance of Financial Asset interest is to be recognized at in the profit and loss account using the effective interest method.**

Contract Asset

- If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as **contract asset** excluding any amount presented as receivable. Contract assets refers to an entities right to consideration in exchange for goods or service that the entity has transferred to customer [Para 107].
- Thus, the contract asset and the receivable i.e. the financial asset are different rights of an entity.
- Contract asset arises when the goods or services are transferred but the payment in respect of such transfer has not been received or has not become due whereas receivable or the Financial asset is an entity's right to consideration that is unconditional. For recognizing receivable, the timing of transfer of goods and service is immaterial.
- Financial Asset can even arise when the promised goods and services has not been transferred but unconditional right to the payment has arisen.

Contract Asset – case study

Analysis of case study

- **In the present case study, the contract asset would represent the amount of revenue recognized against the allocated transaction price in respect of the performance obligation.**
- **In the present case, at the end of first year, CPL has completed 60% of the work. Thus, at the end of first year, 60% of allocated transaction price for construction service i.e. 60% of Rs. 647 Cr. = Rs. 388 Cr. would be recognized as contract asset.**
- **However, since 24% of the 647 crore (Rs. 155.28 crore) has already become due under the Contract, this shall be reflected as financial asset/ receivable.**
- **Hence at the end of the year, the contract asset shall be Rs. 388 crore – Rs. 155.28 crore, i.e. Rs. 232.72 crore.**

Contract Liability

- From para 106 of Ind AS 115, contract liability is an ***entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer***.
- Thus, in case of HAM project, contract liability arises in a situation where the entity has received the consideration from authority or received the right to receive consideration from Authority, but has not transferred the service.
- For instance, contract liability would arise where the concessionaire has received the advance for construction but the project is yet to be constructed.
- Likewise, Contract liability would also be created where some portion of bid project cost is construed to be making up for the O&M activity Thus, if without carrying out the O&M activity, a percentage of bid project cost becomes due to the entity, that portion which relates to the O&M shall become contract liability.

Contract Liability – Case study

Analysis of case study

- **In the present case study, CPL needs to create the contract liability because as per the allocation of transaction price, a portion of bid project cost includes the consideration for O&M; and hence, CPL would need to create a contract liability for such portion of bid project cost that represents consideration for O&M.**
- **Further, the contract liability would arise upon each instance when CPL achieves a construction milestone and the payment for such milestone becomes due from Authority.**
- **At end of Year 1, CPL has completed 60% of construction work and received 28% of bid project cost as milestone payments for first three milestones achieved. Thus, CPL would create a contract liability of 28% of (Rs. 800 Cr - 647 Cr) = 28% of Rs. 153 Cr.= approx. Rs. 43 Cr.**

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THANK YOU

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